July 22, 2002

Supply Inventory Management

Terminal Items Managed by the Defense Logistics Agency for the Navy

(D-2002-131)

Department of Defense
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Acronyms

AAC	Acquisition Advice Code
DLA	Defense Logistics Agency
DIIP	Defense Inactive Item Program
DLIS	Defense Logistics Information Service
FLIS	Federal Logistics Information System
NSN	National Stock Number
NATO	North Atlantic Treaty Organization
SAMMS	Standard Automated Materiel Management System

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-4704

July 22, 2002

MEMORANDUM FOR DIRECTOR, DEFENSE LOGISTICS AGENCY
NAVAL INSPECTOR GENERAL

SUBJECT: Report on Terminal Items Managed by the Defense Logistics Agency for the Navy (Report No. D-2002-131)

We are providing this report for review and comment. This report is the second in a series of reports addressing the management of terminal national stock number items by the Defense Logistics Agency. We considered management comments on a draft of this report when preparing the final report.

DoD Directive 7650.3 requires that all unresolved issues be resolved promptly. We request that the Defense Logistics Agency provide additional comments on Recommendation 1.a. and that the Navy provide additional comments on the potential monetary benefits. Management comments should be provided by September 20, 2002.

If possible, please provide management comments in electronic format (Adobe Acrobat file only). Send electronic transmission to the e-mail addresses cited in the last paragraph of this memorandum. Copies of the management comments must contain the actual signature of the authorizing official. We cannot accept the / Signed / symbol in place of the actual signature. If you arrange to send classified comments electronically, they must be sent over the classified SECRET Internet Protocol Router Network (SIPRNET).

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Tilghman A. Schraden at (703) 604-9186 (DSN 664-9186) (tschraden@dodig.osd.mil) or Mr. Terrance P. Wing at (215) 737-3883 (DSN 444-3883) (twing@dodig.osd.mil). See Appendix B for the report distribution. The team members are listed inside the back cover.

Thomas F. Gimble
Acting
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Office of the Inspector General of the Department of Defense

Report No. D-2002-131 **July 22, 2002**
(Project No. D2001LD-0128.001)

Terminal Items Managed by the Defense Logistics Agency for the Navy

Executive Summary

Who Should Read This Report and Why? DoD personnel who are involved in materiel management should read this report. The report discusses compliance with procedures used to ensure that obsolete terminal national stock number (NSN) items are deleted from the Defense Logistics Agency (DLA) supply system.

Background. This report, the second in a series of reports on terminal NSN items, discusses terminal NSNs managed by the DLA for the Navy. Inspector General of the Department of Defense Report No. D-2002-060, "Management of Terminal Items at the Defense Logistics Agency," March 13, 2002, discusses DLA management of terminal NSNs with no user interest.

DLA supply centers manage more than 4.1 million NSN items. NSN items that are terminal are those stocked and non-stocked items managed by DLA that are not authorized for future procurement. An NSN is generally classified as terminal when either there is no known source of supply for the NSN or the NSN is replaced by another NSN. A terminal item is considered inactive, or obsolete, if there are no current or future requirements anticipated by any registered user or by the integrated materiel manager of the NSN. As of May 2001, DLA supply files included 53,455 terminal NSNs, excluding the clothing and textile, medical, and subsistence commodities, that had the Navy as the only registered user. Data records indicated that the "date of last demand" field for those 53,455 NSNs either had no demand for more than 5 years or was blank.

Results. DLA supply files contained NSNs that could have been deleted because the NSNs supported obsolete Navy requirements. DLA supply files also contained inaccurate Navy user data. A stratified statistical sample of 110 NSNs indicated that 28,023 of 53,455 terminal NSNs were obsolete and actions had not been taken to delete the NSNs from the DLA supply system. The sample also indicated that an additional 8,384 of the 53,455 NSNs were obsolete to Navy requirements, but actions needed to be taken to determine whether there were North Atlantic Treaty Organization or foreign government requirements before the NSNs could be deleted. As a result, DLA and the Navy were incurring unnecessary supply management costs. We projected that the Navy could put about $69 million of funds to better use over the 6-year Future Years Defense Program, FYs 2002 through 2007, by removing the obsolete terminal NSNs identified by this audit from the Navy supply files. The full extent of the monetary benefits will be quantifiable after the same obsolete NSNs are deleted from DLA supply files and after

NSNs with no North Atlantic Treaty Organization or foreign government requirements are identified and deleted from both the Navy and DLA supply systems. Revised DLA procedures for the review of terminal items and controls to remove the Navy as a registered user of DLA-managed obsolete terminal NSNs should ensure that obsolete terminal NSNs are deleted from the supply system. (See the Finding section of the report for the detailed recommendations.)

Management Comments and Audit Response. DLA nonconcurred with the recommendations. DLA stated that including in the Defense Inactive Item Program those terminal items that are in an issue and substitutability standardization relationship would duplicate an existing cancellation process. DLA also stated that because nominal costs are incurred to maintain terminal items in the supply system, there is no benefit to be gained from deleting data on terminal NSNs that may be supporting North Atlantic Treaty Organization or foreign government requirements. The DLA comments were partially responsive. All terminal NSNs do not have an issue and substitutability standardization relationship and, therefore, not all terminal NSNs are subject to the existing cancellation process. Additionally, it is apparent that the existing cancellation process is not working as intended because only one of the eight obsolete terminal NSNs in our sample with an issue and substitutability standardization relationship had been canceled. DLA also provided no valid data to support its statement that terminal NSNs maintained in the supply system incur only minimal costs. To the contrary, DLA reported cost avoidance under its item reduction program of approximately $89 million for the 10-year period ending FY 2001 that was attributed to deleting unneeded items from its supply system. The Navy concurred with the recommendation but nonconcurred with the estimated $69 million of potential monetary benefits. Regarding the recommendation, the Navy stated that actions were taken to remove the Navy as a registered user of obsolete DLA-managed NSNs. Regarding the $69 million of potential monetary benefits, the Navy stated that, based on a DLA cost study, the cost to maintain an obsolete terminal NSN in the supply system is minimal. The Navy comments were responsive to the recommendation but not in regard to the potential monetary benefits. The DLA cost study is not pertinent to cataloging costs incurred by the Navy to maintain an NSN in the Navy supply system. We computed the estimated benefits based on Navy cataloging cost data in a Navy study and the Navy had concurred with our use of the cataloging cost data in response to a prior audit report. See the Finding section of the report for a discussion of management comments and the Management Comments section for the complete text of the comments. We request that DLA and the Navy provide additional comments on the final report by September 20, 2002.

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Background

This report, the second in a series of reports on terminal national stock number (NSN) items, discusses terminal NSNs managed by the Defense Logistics Agency (DLA) for the Navy. Inspector General of the Department of Defense Report No. D-2002-060, "Management of Terminal Items at the Defense Logistics Agency," March 13, 2002, discusses DLA management of terminal NSNs with no user interest.

Materiel Management. DLA supply centers are assigned the primary responsibility for materiel management for a group of items used by either a particular Service or by DoD as a whole. Materiel management responsibilities include cataloging,* requirements computation, procurement direction, distribution management, and disposal direction. DLA supply centers manage more than 4.1 million NSN items.

DoD Guidance. DoD Manual 4100.39-M. "Federal Logistics Information System (FLIS) Procedures Manual," April 1999, provides procedures for DoD organizations to interface with the FLIS. The FLIS is a management system designed to collect, store, process, and provide NSN logistics information. Included in the FLIS is information concerning registered users of NSNs. The FLIS is managed by the DLA Defense Logistics Information Service (DLIS), Battle Creek, Michigan. DoD Manual 4100.39-M defines terminal NSNs as stocked and non-stocked items that are not authorized for future procurement.

DoD Manual 4140.32-M, "Defense Inactive Item Program (DIIP)," August 1992, provides procedures for the systematic elimination of inactive, or obsolete, NSNs from the DLA supply system and states that items no longer needed to support the mission of DoD organizations, other Federal agencies, or the International Logistics Program needlessly consume cataloging and supply system files, machine time, personnel resources, and warehouse space with serious effect on the total supply system. DoD managers at every level are expected to place serious and continuous emphasis on the purging of unneeded items from the materiel inventory and active catalog files.

DLA Procedures. DLA Manual 4140.2, "Supply Operations Manual," July 1, 1999, provides policy, uniform guidance, and procedures for DLA supply

* The act of naming, classifying, describing, and numbering each item repetitively used, purchased, stocked, or distributed so as to distinguish each item from every other item. Also included is the maintenance of information related to the item and the dissemination of that information to item users.

centers to systematically review and eliminate inactive items of supply from the DLA supply system. An item is considered inactive, or obsolete, if there are no current or future requirements anticipated by any registered user or by the integrated materiel manager of the NSN. The manual requires that the commander of each supply center designate a DIIP monitor to act as the focal point for all matters concerning the DIIP. DIIP monitor responsibilities include initiating timely actions to delete obsolete items from the DLA supply system after user interest has been withdrawn.

Terminal NSNs. NSN items that are terminal are those stocked and non-stocked items managed by DLA that are not authorized for future procurement. An NSN is generally classified as terminal when either there is no known source of supply for the NSN or the NSN is replaced by another NSN. DLA uses acquisition advice codes (AACs) to indicate how and under what restrictions NSNs will be acquired. NSNs assigned an AAC of V or Y are coded as terminal. AAC-V identifies terminal NSNs with DLA inventory. AAC-Y identifies terminal NSNs with no DLA inventory. As of May 2001, DLA supply files included 53,455 terminal NSNs, excluding the clothing and textile, medical, and subsistence commodities, that had the Navy as the only registered user. Data records indicated that the "date of last demand" field for those 53,455 NSNs either had no demand for more than 5 years or was blank.

Objectives

The overall audit objective was to evaluate DLA management of terminal NSN items. This report addresses the terminal NSNs managed by DLA for the Navy. We also reviewed the management control programs as they applied to the audit objective. See Appendix A for a discussion of the audit scope and methodology, our review of the management control program, and prior audit coverage.

Terminal Items With Navy Interest

DLA supply files contained NSNs that could have been deleted because the NSNs supported obsolete Navy requirements. DLA supply files also contained inaccurate Navy user data. A stratified statistical sample of 110 NSNs indicated that 28,023 of 53,455 terminal NSNs were obsolete and actions had not been taken to delete the NSNs from the DLA supply system. The sample also indicated that an additional 8,384 of the 53,455 NSNs were obsolete to Navy requirements, but actions needed to be taken to determine whether there were North Atlantic Treaty Organization (NATO) or foreign government requirements before the NSNs could be deleted. The NSNs were not reviewed for obsolescence because DLA guidance excluded terminal NSNs from the DIIP and there was no management control to systematically identify terminal NSNs for item manager review. In addition, the Navy did not routinely review and withdraw itself as a user of the terminal NSNs. As a result, DLA and the Navy were incurring unnecessary supply management costs. We projected that the Navy could put about $69 million of funds to better use over the 6-year Future Years Defense Program, FYs 2002 through 2007, by removing the obsolete terminal NSNs identified by this audit from the Navy supply files. The full extent of the monetary benefits will be quantifiable after the same obsolete NSNs are deleted from DLA supply files and after NSNs with no NATO or foreign government requirements are identified and deleted from both the Navy and DLA supply systems.

DIIP Process

Each year, the DLA Standard Automated Materiel Management System (SAMMS) screens all NSNs in the DLA supply centers' supply files to determine the NSNs that are eligible for the DIIP. Two criteria for determining eligible NSNs are that the NSN has been in the Federal supply system for 7 years and that the NSN has experienced no demand in the past 2 years. After eligible NSNs have been identified, SAMMS screens the NSNs against catalog and supply data to determine whether the NSNs qualify for the DIIP. NSNs are excluded from the DIIP for various reasons, including when an NSN is assigned an AAC of either V or Y (terminal items). NSNs that qualify for the DIIP are sent to the DLIS to query FLIS user data. NSNs with registered users, primarily the Military Departments, qualify for the DIIP and are referred to the Military Departments to review the NSNs and notify the supply centers to either delete or retain the NSNs.

Review of Terminal NSNs

DLA supply files contained terminal NSNs that were obsolete to Navy requirements. We reviewed a statistical sample of 110 of 53,455 terminal NSNs with the Navy as the only registered user. We discussed each NSN with Navy personnel to determine whether the Navy had a valid requirement for the NSN. We also discussed the NSNs that had no valid Navy requirements with DLA personnel to determine whether the NSNs could be deleted from the supply system.

Of the 110 NSNs in our sample, 57 were obsolete and the NSNs could be deleted from the supply system. For 49 of the obsolete NSNs, Navy personnel stated that the NSNs were obsolete because either they were no longer used on an active weapon system or the end item or weapon system the NSNs were used on were obsolete. For the remaining eight NSNs, Navy personnel stated that each of the NSNs had been replaced by another NSN. An NSN item that has been replaced by another NSN item should generally not be considered obsolete until all DLA assets for the NSN are issued. Our review of DLA supply records showed that there were no DLA assets on hand for the eight NSNs that had been replaced. We projected the 57 terminal NSNs across the universe of 53,455 terminal NSNs and estimated that 28,023 terminal NSNs should have had actions taken to delete them from the supply system. Appendix A provides a detailed discussion of the sampling methodology and projected audit results.

Navy personnel identified an additional 19 NSNs in our sample that were obsolete to Navy requirements; however, the NSNs required NATO or foreign government review before the NSNs could be deleted from the supply system. We projected the 19 terminal NSNs across the universe of 53,455 terminal NSNs and estimated that 8,384 terminal NSNs were obsolete to Navy requirements but required NATO or foreign government review before the NSNs could be deleted from the supply system.

DLA Management Controls

DLA did not review terminal NSNs for obsolescence primarily because DLA Manual 4140.2 excluded terminal NSNs from the DIIP and there was no management control to systematically identify for item managers terminal NSNs that should be reviewed for obsolescence. DLA item managers stated that reviewing terminal NSNs was not a high priority and they concentrated on managing NSNs that had current or future requirements. Item managers also stated that SAMMS did not provide recurring reports to them to identify terminal NSNs and the length of time the NSNs had been in a terminal status. Navy

personnel stated that had terminal NSNs been included in the DIIP, they would have submitted transactions to withdraw the Navy as a user of the NSNs.

Withdrawal of User Interest

DLA supply files contained inaccurate Navy user information because the Navy had not withdrawn itself as a registered user of the obsolete NSNs.

DLA Supply Files. DLA supply records showed the Navy as a registered user for each of the 76 NSNs that were obsolete to Navy requirements. In accordance with DoD Manual 4100.39-M, when a registered user no longer has a requirement for an NSN, the user must submit a transaction through the FLIS requesting a withdrawal of user interest. The procedures allow registered users to withdraw their interest in an NSN at any time. It is important that users withdraw their interest in a timely manner because DLA screens NSNs that qualify for the DIIP through the FLIS to determine whether there are any registered users of the NSNs.

Navy Supply Files. Navy supply records for the 76 obsolete NSNs showed that 12 of the NSNs had been deleted from the Navy files even though DLA supply records had the Navy as a registered user for the NSNs. The records also showed that for four of the deleted NSNs, the Navy had deleted those NSNs from its files more than 10 years ago. For example, NSN 5940-00-051-7119 (terminal board) was deleted from Navy supply files in February 1985, yet the NSN was managed as a terminal item by the Defense Supply Center Richmond. Navy personnel were unable to explain why the 12 NSNs had been deleted from Navy supply files but not from DLA supply files.

Cost of Maintaining Obsolete NSNs

DLA Costs. In September 1999, the DLA Office of Operations Research and Resource Analysis published a study to provide cost data in support of item reduction studies. The study included cost avoidance data for eliminating an existing NSN from the DLA supply system. The following table shows the results of the study.

Cost of Maintaining NSNs

Category	Cost
Average annual cost to maintain a stocked NSN	$ 400
Average annual cost to maintain a non-stocked NSN	200
Average cost to delete a stocked or non-stocked NSN	57
Remaining life-cycle cost avoided by eliminating a stocked NSN	1,495
Remaining life-cycle cost avoided by eliminating a non-stocked NSN	747

In prior audits, we used the cost study to calculate the potential for putting funds to better use by deleting NSNs from the DLA supply system. In May 2001, DLA concurred with our use of the cost study, stating that "the best data available to determine the cost of deleting NSNs from the system is the DLA Operations Research and Resource Analysis study and we do not dispute the estimates of cost avoidance by the team." In August 2001, DLA amended its comments related to our use of the cost study and stated that the study should not be used as a basis to determine cost avoidance associated with retaining inactive NSNs. We disagreed with DLA and have not resolved our differences on the cost factors for calculating the potential funds that could be put to better use. DLA is conducting a study to determine the cost of maintaining an inactive item in the supply system that is planned to be completed in July 2002. After the study is completed, we will evaluate the results to determine whether it provides a valid basis to compute and report the cost avoidance applicable to this report.

Navy Costs. "Naval Air Systems Command Level of Repair Analysis Default Data Guide," May 1999, estimates costs related to repair analyses. The Guide shows a recurring annual cataloging cost of $500 per NSN. The cost estimate was provided by the Naval Inventory Control Point Philadelphia, Pennsylvania. Based on the sample results (45 obsolete NSNs still recorded in Navy supply files), we projected that there were 23,054 obsolete terminal NSNs in the Navy supply files. We did not include the 19 NSNs that required NATO or foreign government review in the projection because Navy supply records may be needed if NSNs are not obsolete. We multiplied the 23,054 NSNs by the $500 per NSN cost to determine an annual cost of $11.5 million. We calculated funds of about $69 million could be put to better use over the 6-year Future Years Defense Program, FYs 2002 through 2007, by removing the obsolete terminal NSNs identified by this audit from the Navy supply files.

Management Comments on the Finding and Audit Response

Management Comments. DLA stated that the item used as an example in the report, NSN 5940-00-051-7119, had been canceled in the FLIS in 1985 and that the SAMMS Contracting Technical File has no record of the NSN. DLA also stated that our description of one of the criteria for determining whether an NSN is eligible for the DIIP, the length of time an NSN had experienced no demand, should be changed from 2 years to 5 years.

Audit Response. The example in the report emphasized the discrepancy between DLA supply files and the Navy supply files. NSN 5940-00-051-7119 was in the DLA supply system as late as May 2002. The NSN was also in a May 2001 database of terminal NSNs that DLA provided to us. We were aware that the FLIS indicated the NSN was canceled in 1985. That discrepancy between the FLIS and DLA supply files existed for more than 16 years, which made it apparent to us that DLA procedures to remove obsolete terminal NSNs from its supply system were not working as intended.

DLA uses a more stringent criterion for entering an NSN in the DIIP than the DoD requirement. DoD Manual 4140.32 states that an NSN will be eligible for the DIIP if it has experienced no demand for 5 years. DLA Manual 4140.2 states that an NSN will be eligible for the DIIP if it has experienced no demand for 2 years. We cited the DLA 2-year criterion in the report because we evaluated the DLA DIIP process.

Recommendations, Management Comments, and Audit Response

1. We recommend that the Director, Defense Logistics Agency:

a. Revise Defense Logistics Agency Manual 4140.2, "Supply Operations Manual," July 1, 1999, to include terminal national stock number items with registered users in the Defense Inactive Item Program.

DLA Comments. DLA nonconcurred, stating that if a terminal item is in an issue and substitutability standardization relationship (unconditional interchangeability or substitutability between or among items of supply) that SAMMS mechanically generates a cancellation when the terminal NSN reaches a zero asset position and that including terminal items in the DIIP would duplicate an existing cancellation process.

Audit Response. DLA comments were not responsive. All terminal NSNs do not have an issue and substitutability standardization relationship and, therefore, not all terminal NSNs are subject to the existing cancellation process. Of the 57 obsolete terminal NSNs in our sample, only 8 had an issue and substitutability standardization relationship. Additionally, it is apparent that for NSNs that do have an issue and substitutability standardization relationship that the existing cancellation process is not working as intended because only one of the eight NSNs had been canceled. The DLA comments were also contrary to DLA Regulation 4140.66, "Elimination of Duplication in the Management and Logistics Support of Interchangeable and Substitutable Items," August 1997. The regulation states that, under certain conditions, issue and substitutability standardization items will be included in the DIIP process. We request that DLA reconsider its position and provide additional comments in response to the final report.

b. Maintain and report statistics on how many terminal national stock number items are deleted from the supply system after the North Atlantic Treaty Organization and foreign governments review the items.

DLA Comments. DLA nonconcurred, stating that there would be no benefit to implementing this recommendation. DLA stated that the only costs incurred for maintaining terminal and inactive NSNs are machine storage costs, which are not affected by the number of items contained in the system, and a nominal depot cost if assets are on hand. Once an item is coded terminal, no further supply management costs are attributable to that item. DLA plans to complete a new study to quantify the costs to maintain inactive NSNs in the supply system by the end of July 2002.

Audit Response. DLA comments were partially responsive. DLA provided no valid data to support its statement that terminal items maintained in the supply system incur only minimal costs. To the contrary, DLA reported cost avoidance under its item reduction program of approximately $89 million for the 10-year period ending FY 2001 that was attributed to deleting unneeded items from its supply system. However, we will evaluate the updated cost data provided by the DLA study.

2. We recommend that the Commander, Naval Supply Systems Command establish controls to ensure that the Navy is removed as a registered user of Defense Logistics Agency-managed national stock number items that are no longer required.

Navy Comments. The Navy concurred with the recommendation but nonconcurred with the estimated $69 million of potential monetary benefits. Regarding the recommendation, the Navy stated that various actions were taken

to identify and delete obsolete NSNs from its supply files and to remove the Navy as a registered user of the obsolete NSNs. Regarding the estimated $69 million of potential monetary benefits, the Navy stated that the Navy cost study we used to compute the monetary benefits relates to the recurring administrative cost of maintaining a physical item of supply in the wholesale supply system and our audit addresses the cost to maintain an NSN record. Additionally, based on a DLA study, the cost to maintain an obsolete terminal NSN in the supply system is minimal to nonexistent.

Audit Response. Navy comments were responsive to the recommendation. Regarding the potential monetary benefits, the Navy cost study uses an estimated value of $500 for annual cataloging costs, which was the amount we used to compute the potential monetary benefits. The study does not state that the $500 cost is incurred only if there is a physical item in the supply system. We hold that the cataloging costs not only are incurred for maintaining a physical item in the supply system but are also incurred for non-stocked and out-of-stock NSNs. The Navy's comments regarding our use of the study were also contrary to comments it provided on a prior audit report. In response to that report, the Navy concurred with our use of the cataloging costs to estimate potential monetary benefits the Navy could realize by deleting DLA-managed inactive NSNs from the Navy supply system. Additionally, the DLA study referenced by the Navy is not pertinent to cataloging costs incurred by the Navy. The DLA study was based on DLA cost data, not Navy cost data. We request that the Navy reconsider its position and provide additional comments on the potential monetary benefits in response to the final report.

Appendix A. Scope and Methodology

We reviewed a statistical sample of 110 of 53,455 terminal NSNs managed by DLA to determine whether the NSNs were obsolete. The NSNs were taken from DLA supply records as of May 2001. We interviewed Navy personnel from the Naval Supply Systems Command, Mechanicsburg, Pennsylvania; Naval Inventory Control Point offices in Mechanicsburg and Philadelphia, Pennsylvania; the Naval Air Systems Command, Patuxent River, Maryland; and the Naval Sea Systems Command, Washington, D.C., to determine whether the NSNs were obsolete. We interviewed DLA personnel from all three Defense supply centers (Columbus, Ohio; Philadelphia, Pennsylvania; and Richmond, Virginia) to determine whether the obsolete NSNs identified in the audit could be deleted from DLA supply files. We interviewed DLA headquarters personnel to determine the rationale for excluding terminally coded items from the DIIP. The documents we reviewed included DLA standard operating procedures, DoD and DLA guidance, cataloging files, demand histories, and supply records and were dated August 1992 through May 2002.

General Accounting Office High-Risk Area. The General Accounting Office has identified several high-risk areas in DoD. This report provides coverage of the Defense Inventory Management high-risk area.

Use of Computer-Processed Data. To identify terminal NSNs, we relied on computer-processed data from SAMMS that was provided by DLA. We did not perform a formal reliability assessment of the computer-processed data. To the extent that we reviewed the data, we found some errors in supply codes, but those errors did not preclude the use of other computer-processed data to meet the audit objectives and those errors would not change the conclusions in this report.

Universe and Sample. DLA provided the audit team a database of terminal NSNs. The database was provided from May 2001 supply records of NSNs, excluding those in the clothing and textile, medical, and subsistence commodities, for which the "date of last demand" field in SAMMS either indicated no demand for more than 5 years or was blank. That database contained 255,915 NSNs. Of the 255,915 NSNs, 103,396 were terminal NSNs with only one registered user. Of the 103,396 NSNs, 53,455 were NSNs with the Navy as the only registered user.

Statistical Sampling Methodology. The purpose of the statistical sampling plan was to estimate the number of terminal NSNs in the DLA supply system with only Navy interest that were obsolete. DLA supply records identified 53,455 terminal NSNs, for which, as of May 2001, the date of last demand field either indicated no demand for more than 5 years or was blank. The sampling design

was a stratified attribute design. The universe was distributed across four locations. SAMMS identified one location as the Defense Electronic Supply Center, even though the center had been disestablished and management of NSNs managed by the center had been assumed by the Defense Supply Center Columbus. The following table shows the distribution of the NSNs from the universe and our sample at each of the four locations (Defense Electronic Supply Center [DESC], Defense Supply Center Columbus [DSCC], Defense Supply Center Philadelphia [DSCP], and Defense Supply Center Richmond [DSCR]).

Universe and Sample by Location

Location	Universe	Sample
DESC	18,050	35
DSCC	5,554	20
DSCP	17,580	30
DSCR	12,271	25
Total	**53,455**	**110**

Of the 110 NSNs reviewed, 57 were obsolete and 19 required review for current NATO or foreign government requirements. Based on the sample results, we projected with a 95-percent confidence level that between 22,172 and 33,875 NSNs of the 53,455 NSNs in the universe were obsolete and actions should be taken to delete the NSNs from the supply system. The midpoint of that projected range is 28,023 NSNs. Likewise, we projected with a 95-percent confidence level that between 3,810 and 12,959 of the NSNs needed to be reviewed for NATO or foreign government requirements before the NSNs could be deleted. The midpoint of that projected range is 8,384.

Of the 57 NSNs that were obsolete, 45 were still recorded in the Navy supply files. Based on the sample results, we projected with a 95-percent confidence level that between 17,788 and 28,319 NSNs of the 53,455 in the universe were obsolete and still recorded in the Navy supply files. The midpoint of that projected range is 23,054 NSNs.

Use of Technical Assistance. Personnel in the Quantitative Methods Division, Office of the Assistant Inspector General for Auditing of the Department of Defense developed the statistical sampling plan and selected the sample for this audit.

Audit Dates and Standards. This audit was performed from May 2001 through May 2002 in accordance with generally accepted government auditing standards.

Contacts During the Audit. We visited or contacted individuals and organizations within DoD. Further details are available on request.

Management Control Program Review

DoD Directive 5010.38, "Management Control (MC) Program," August 26, 1996, and DoD Instruction 5010.40, "Management Control (MC) Program Procedures," August 28, 1996, require DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Scope of the Review of the Management Control Program. We reviewed the adequacy of DLA and Navy management controls over reviewing terminal NSNs. We reviewed DLA and Navy self-evaluations applicable to those controls.

Adequacy of Management Controls. As defined by DoD Instruction 5010.40, we identified material management control weaknesses at DLA and the Navy. DLA excluded terminal NSNs from the DIIP and there was no control to systematically identify terminal NSNs for item manager review. The Navy was not withdrawing its user interest when there were no future requirements for DLA-managed NSNs. Recommendations 1. and 2. in this report, if implemented, will correct the material weaknesses identified by the audit. Correction of the material management control weaknesses could result in potential monetary benefits for the Navy of about $69 million over the 6-year Future Years Defense Program, FYs 2002 through 2007. The potential monetary benefits for DLA have not been calculated because of differences with DLA in the cost factors that should be used in the calculation. The full extent of the monetary benefits will be quantifiable after the obsolete NSNs identified by this audit are deleted from DLA supply files and after NSNs with no NATO or foreign government requirements are identified and deleted from both the Navy and DLA supply systems. A copy of the report will be provided to the senior official responsible for management controls in DLA and the Navy.

Adequacy of Management's Self-Evaluation. DLA did not identify reviewing terminal NSNs as an assessable unit and, therefore, did not identify or report the material management control weaknesses identified by the audit.

The Navy did not identify withdrawal of user interest in DLA-managed terminal NSNs as an assessable unit and, therefore, did not identify or report the material management control weaknesses identified by the audit.

Prior Coverage

During the past 5 years, the Inspector General of the Department of Defense (IG DoD) has issued several reports discussing obsolete NSNs. Unrestricted IG DoD reports can be accessed over the Internet at http://www.dodig.osd.mil/audit/reports.

IG DoD

IG DoD Report No. D-2002-060, "Management of Terminal Items at the Defense Logistics Agency," March 13, 2002

IG DoD Report No. D-2001-187, "Defense Logistics Agency Items Supporting Obsolete Army Weapon Systems," September 27, 2001

IG DoD Report No. D-2001-131, "Items Excluded From the Defense Logistics Agency Defense Inactive Item Program," May 31, 2001

IG DoD Report No. D-2001-035, "Management of Potentially Inactive Items at the Defense Logistics Agency," January 24, 2001

IG DoD Report No. D-2000-185, "Allegations to the Defense Hotline Concerning Management of Obsolete Reparable Items," September 7, 2000

Appendix B. Report Distribution

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Defense Logistics Agency Comments

DEFENSE LOGISTICS AGENCY
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IN REPLY
REFER TO J-33

MAY 21 2002

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING
DEPARTMENT OF DEFENSE

SUBJECT: Draft of a Proposed Audit Report – Terminal Items Managed by the Defense Logistics Agency for the Navy (Project No. D2001LD-0128.001), dated March 22, 2002

Comments on the finding and recommendations of the subject draft report are attached.

We appreciate the opportunity to comment on the draft report. The point of contact for this is Mr. Brian Schutsky, Logistics Policy and Acquisition Management (J-33), 703-767-2657 or Ms. Annell Williams, Internal Review Office, 703-767-6274.

FRANK LOTTS
Deputy Director
Logistics Operations

Attachment
DLA Comments

Subject: Terminal Items Managed by the Defense Logistics Agency for the Navy, March 22, 2002, Project No. D2001LD-0128.001

Finding: DLA supply files contained NSNs that could have been deleted because the NSNs supported obsolete Navy requirements. DLA supply files also contained inaccurate Navy user data. A stratified statistical sample of 110 NSNs indicated that 28,023 of 53,455 terminal NSNs were obsolete and actions had not been taken to delete the NSNs from the DLA supply system. The sample also indicated that an additional 8,384 of the 53,455 NSNs were obsolete to Navy requirements, but actions needed to be taken to determine whether there were North Atlantic Treaty Organization (NATO) or foreign government requirements before the NSNs could be deleted. The NSNs were not reviewed for obsolescence because DLA guidance excluded terminal NSN from the DIIP and there was no management control to systematically identify terminal NSNs for item manager review. In addition, the Navy did not routinely review and withdraw itself as a user of the terminal NSNs. As a result, DLA and the Navy were incurring unnecessary supply management costs. We projected that the Navy could put about $69 million of funds to better use over the 6-year Future Years Defense Program, FYs 2002 through 2007, by removing the obsolete terminal NSNs identified by this audit from the Navy supply files. The full extent of the monetary benefits will be quantifiable after the same obsolete NSNs are deleted from DLA supply files and after NSNs with no NATO or foreign government requirements are identified and deleted from both the Navy and DLA supply systems.

DLA Comments: The one example provided on page 5, NSN 5940-00-051-7119 (terminal board) in the draft report was cancelled in the Federal Logistics Information System in 1985 and the Standard Automated Materiel Management System Contracting Technical Data File for Defense Supply Center Richmond has no record of the NSN.

Recommendations: DoDIG recommends that the Director, DLA:

1. a. Revise Defense Logistics Agency Manual 4140.2, "Supply Operations Manual," July 1, 1999, to include terminal national stock number items with registered users in the Defense Inactive Item Program.

DLA Comments: NON-CONCUR. If the terminal item is in a standardization (DoD I&S) relationship, when the Item Manager establishes the Requirements Family, SAMMS mechanically generates a cancellation when the terminal NSN reaches a zero asset position. Including these items in DIIP would duplicate an existing cancellation process. Terminal items which are discontinued due to support by Next Higher Assembly (NHA) or Fabricate Assemble (FA) should not be included in DIIP. Phrase Coding applied to these type items portrays the relationships between the terminal item and the NHA/FA items in FLIS. When User Interest is removed (as would occur in DIIP) the Phrase Code relationships in FLIS are deleted/lost.

Subject: Terminal Items Managed by the Defense Logistics Agency for the Navy, March 22, 2002, Project No. D2001LD-0128.001

Disposition: Action is considered complete.

b. Maintain and report statistics on how many terminal national stock number items are deleted from the supply system after the North Atlantic Treaty Organization and foreign governments review the items.

DLA Comments: NON-CONCUR. For the reasons stated below under "Potential Monetary Benefits" there would be no benefit to implementing this recommendation.

Disposition: Action is considered complete.

Potential Monetary Benefits: The potential monetary benefits for DLA have not been calculated because of differences with DLA in the cost factors that should be used in the calculation. The full extent of the monetary benefits will be quantifiable after the obsolete NSNs identified by this audit are deleted from DLA supply files and after NSNs with no NATO or foreign government requirements are identified and deleted from both the Navy and DLA supply systems.

DLA Comments: The only costs incurred for maintaining terminal and inactive items are machine storage costs, which are not effected by the number of items contained in the system, and a nominal depot cost provided that assets are on-hand. Although the method of support for an item may be through stock in the depot, that does not always equate to assets on-hand. Once an item is coded terminal no further supply management costs are attributable to that item. DORRA plans to complete a new study to quantify the costs of inactive items by the end of July 2002.

ADDITIONAL COMMENTS: The description of the DIIP process on page three has a typographical error stating "...no demand in the past 2 years." This should state in the past 5 years.

Action Officer: Mr. Brian Schutsky

Department of the Navy Comments

DEPARTMENT OF THE NAVY
OFFICE OF THE ASSISTANT SECRETARY
RESEARCH, DEVELOPMENT AND ACQUISITION
1000 NAVY PENTAGON
WASHINGTON, DC 20350-1000

12 June 2002

MEMORANDUM FOR DEPARTMENT OF DEFENSE ASSISTANT INSPECTOR GENERAL FOR AUDITING

SUBJECT: DRAFT DODIG AUDIT REPORT ON TERMINAL ITEMS MANAGED BY THE DEFENSE LOGISTICS AGENCY FOR THE NAVY (PROJECT NO. D2001LD-0128.001)

Reference: Your memo of 22 March 2002

We reviewed your report forwarded by reference. Our comments on recommendation 2 are provided in Attachment 1.

William J. Schaefer
Deputy Assistant Secretary of the Navy
Planning, Programming and Resources

Attachment:
1. Department of the Navy's Comments

cc:
NAVIG-4
NAVSUP (91F)

DEPARTMENT OF THE NAVY RESPONSE
TO
DODIG DRAFT REPORT OF 22 MARCH 2002
ON
TERMINAL ITEMS MANAGED BY THE DEFENSE LOGISTICS AGENCY FOR THE NAVY
(PROJECT NO. D2001LD-0128.001)

Recommendation

2. We recommend the Commander, Naval Supply Systems Command (NAVSUP) establish controls to ensure the Navy is removed as a registered user of DLA-managed national stock number items that are no longer required.

Comment.

In 2001 Naval Inventory Control Point - Philadelphia (NAVICP-P) worked with the Naval Air Systems Command (NAVAIR) to identify and issue disposal directives for all obsolete weapons systems. The result was the deletion of several thousand items from our active files and the removal of the Navy as a registered user in the Federal Logistics Information System (FLIS). NAVICP-P has taken steps to establish this procedure as an annual process and is currently reviewing all weapons systems to identify the CY 2002 universe. Estimated completion date, which includes processing of obsolete data purges for all obsolete weapons systems, is December 2002.

Also, a diagnostic tool has been developed to be run annually, to identify all non-Navy managed consumable items of supply that are reflected in the NAVICP database without a valid weapons system as a next higher assembly. We will take actions to delete these items from our active files and remove the NAVICP as a user in the FLIS database. Estimated completion date is September 2002.

NAVSUP, in concert with the NAVICP, has implemented the Configuration and Technical Notification Program (CaTNP). The CaTNP process uses a Configuration Item Status Sheet (CISS) to alert the managing Defense Supply Center (DSC) of an NSN's terminal status, as it applies to Navy applications. The DSC will then take the appropriate supply management action which may include formally coding the item terminal, creating interchangeability with a superseding item of supply, or reacting to the anticipated decrease in Navy demand by amending on-going procurement vehicles or adjusting demand variables to be used in future demand forecasting. The CaTNP process was implemented as a Research and Development effort in July 2000 with the three DSCs actively involved in the development of the CaTNP process from its inception. Efforts are now underway by NAVSUP and DLA to introduce the CaTNP process to the Army and Air Force. To date the process continues to evolve as the

NAVICP and DSC have worked closely with NAVSUP and DLA HQ to factor in process improvements as required.

Regarding the comment that "Navy could put $69 million of funds to better use", we do not concur. The NAVAIR LORA Default Desk Guide uses an estimated default value of $500 for recurring cataloging cost. This is the recurring administrative cost expressed in whole dollars, of maintaining a physical item of supply in the wholesale supply system for one year. The DODIG study refers to the cost to maintain an NSN record. Based upon the DOD DLA report DLA-98-PB80232, the cost to maintain an NSN breaks down as follows:

DSC marginal maintenance cost	= $195.72 per NSN
DLA NSN contract admin cost	= $ 5.07 per NSN
Defense Depot operating cost (stocked only)	= $197.53 per NSN
DLIS Cataloging cost	= $ 1.12 per NSN

For NSNs that are terminal/obsolete, inventory management/NSN maintenance is minimal to nonexistent which reduces the $195.72 to essentially $0. These items are not procured which eliminates the $5.07 contract admin cost. We assume the vast majority of these items are not stocked, eliminating the Depot cost. That leaves $1.12 DLIS cost. It must also be remembered that some inactive/obsolete NSNs must be retained for logistic purposes including configuration identification and control and for weapon system reactivation. The $56.84 cost to delete an NSN per the cited study also needs to be considered.

Team Members

The Readiness and Logistics Support Directorate, Office of the Assistant Inspector General for Auditing of the Department of Defense prepared this report. Personnel of the Office of the Inspector General of the Department of Defense who contributed to the report are listed below.

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